WHAT'S WRONG WITH CHAPTER 11?

Charles J. Tabb†

TABLE OF CONTENTS

ABSTRACT 558
INTRODUCTION 558
I. THE DREAM: WHAT WE WANT CHAPTER 11 TO BE 559
  A. *Maximize Firm Value* 560
  B. *Equitable Distribution of Firm Value* 562
  C. *Save Jobs* 564
  D. *Minimize the Ripple Effect of Failure* 565
  E. *The Cure is Not Worse than the Disease* 566
II. THE NIGHTMARE: WHAT CHAPTER 11 IS 568
  A. *Goodbye Traditional Chapter 11s: It's all About § 363 Sales Now* 570
  B. *Secured Lenders Rule & Get It All* 574
  C. *Unfair & Inequitable Distribution of Value* 578
  D. *Forum Shopping & the Race to the Bottom* 583
  E. *Judicial Legislation Under § 105(a)* 587
III. MAKING THE DREAM A REALITY 589
  A. *Rx # 1: Making Sales Just "Sales" Again* 590
  B. *Rx # 2: Resurrect the "Perishability" or "Emergency" Test for Sales* 590
  C. *Rx # 3: Limit Secured Creditors to Foreclosure Value* 591
  D. *Rx # 4: Open Up DIP Financing & Eliminate Draconian Terms* 592
  E. *Rx # 5: Eliminate All Preferential Priority-Altering Payments* 593
  F. *Rx # 6: Curtail Venue Choice and Forum Shopping* 594
  G. *Rx #7: No More Judicial Legislation* 594
CONCLUSION 595

---

† Mildred Van Voorhis Jones Chair in Law Emeritus, University of Illinois College of Law; Of Counsel, Foley and Lardner LLP. The opinions expressed herein are solely those of the author. I want to thank Soffia Helen Kuehner Gray of the University of Illinois College of Law Class of 2019 for her invaluable research and editorial assistance. An earlier version of this paper was presented at the American Bankruptcy Institute's "Valcon" conference in February 2019. I am honored to participate in this symposium dedicated to my good friend Samuel Gerdano, for whom I have the utmost admiration and respect, and whose contributions to the bankruptcy world are unmatched.

ABSTRACT

The time has come to cast a discerning eye at Chapter 11 and examine how it is currently broken and what fixes can be made to improve it. This Article first explains what the congressional reformers of the 1970s dreamed that Chapter 11 could and should be and identifies five core normative goals that Chapter 11 should promote. I then examine how Chapter 11 has failed, and has become a nightmare rather than a dream, and discuss five critical ways in which Chapter 11 in practice fails to achieve the normative ideals previously identified. I conclude by identifying and explaining seven possible reforms that, if implemented, could help transform Chapter 11 from the current nightmare to the normative ideal dream: (1) making sales once against just sales again; (2) resurrecting the "perishability" or "emergency" test for sales; (3) limiting secured creditors to foreclosure value; (4) opening up debtor-in-possession (DIP) financing terms and eliminating draconian terms; (5) eliminating all preferential priority-altering payments; (6) curtailing venue choice and forum shopping; and (7) eradicating judicial legislation.

INTRODUCTION

In considering "what's wrong with Chapter 11?," neither the tyrannical yoke of debtor-in-possession (DIP) financing, nor the expensive albatross of exorbitant attorneys' fees, nor the effective capture of the Chapter 11 process by controlling secured lenders effectively and essentially foreclosing on their collateral through controlled § 363 sales, or even the ugly specter of race-to-the-bottom venue forum shopping, or any other topic which experienced bankruptcy practitioners brood about (or gloat about, depending on which ox they represent in the goring process) comes to mind. Rather, my mind turned immediately to the passage in Ecclesiastes, which says: "What has been will be again, what has been done will be done again; there is nothing new under the sun."[1]

I had this passing thought because I recalled giving a talk at and publishing an article for another bankruptcy symposium—over a quarter century ago—on the topic "the future of Chapter 11,"[2] in which I examined the then-trendy criticisms of Chapter 11,[3] and how the reality of Chapter 11 in practice had diverged from the dream envisioned by the 1970s reformers and mused about the prospects for reform.

---

1. Eccles. 1:9 (New Int'l Version).
2. *See* Charles J. Tabb, *The Future of Chapter 11*, 44 S.C. L. REV. 791, 792 (1993).
3. *Id.* The best-known critique of Chapter 11 at that time was Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043, 1043 (1992). *Id.*

Perhaps the time has come yet again to cast a discerning eye at Chapter 11 and ponder what is broken and what fixes could be made. The American Bankruptcy Institute went down this same road of reflection, review, and recommendation for reform of Chapter 11 with its epic study from 2012 to 2014. This Article will draw with considerable gratitude from the ABI's "Final Report and Recommendations" from the Commission to Study the Reform of Chapter 11, published in 2014.[4]

This Article will proceed as follows. Part I will describe the dream: what it is that these scholars and reformers of the 1970s, including Congress, idealized and hoped (and still idealize and hope!) that Chapter 11 would and could be. I will consider, in an ideal world, what positive goods Chapter 11 would produce. Part II then will describe the nightmare of what Chapter 11 actually has become in our present reality. I will examine what Chapter 11 is really like, and how that reality diverges from the normative dream. Finally, Part III will identify some reforms that could help make the dream a reality, solve the most pressing problems, and help us wake up from the collective nightmare of Chapter 11.

I. THE DREAM: WHAT WE WANT CHAPTER 11 TO BE

The essence of the dream of why Chapter 11 exists was encapsulated by the 1977 House Report to the Bankruptcy Code:

> The purpose of a business reorganization case, unlike a liquidation case, is to restructure a business's finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders. The premise of a business reorganization is that assets that are used for production in the industry for which they were designed are more valuable than those same assets sold for scrap.[5]

Parsing that statement, and adding some other normative ideals, in summary the primary justifications for Chapter 11 on which this Article will focus are as follows. First, Chapter 11 should help maximize the value of the firm. Second, it must distribute that realized value fairly and equitably amongst deserving stakeholders, in a way that mirrors their bargained-for non-bankruptcy entitlements. Third, it should save jobs. Fourth, it should minimize the ripple effect through the broader economy from a firm's failure. Fifth, it must do those first four things at an acceptable cost, and without causing more harm than good; that is, the cure should not be worse than the disease.

---

4. *See* AMERICAN BANKRUPTCY INSTITUTE COMMISSION TO STUDY THE REFORM OF CHAPTER 11, FINAL REPORT AND RECOMMENDATION (2014) (hereinafter "ABI REPORT"), http://commission.abi.org/full-report.

5. H.R. Rep. No. 95-595, at 220 (1977).

A. Maximize Firm Value

Point one, and the most often repeated justification for Chapter 11, is to *maximize the value of the debtor firm*.[6] The operative assumption is that there is a going-concern surplus for a reorganized firm over and above its liquidation value.[7] In short, the most fundamental reason for having a corporate rescue procedure such as Chapter 11 is to maximize value for the benefit of all stakeholders in the enterprise.[8] More money is better than less. What was true a quarter-century ago remains true today: "Point one, then, is that a business is worth more alive than dead—i.e., it is worth more as a going concern than in a forced sale liquidation; and that all affected parties, defined broadly, benefit if that going concern is maintained."[9]

Of course, the foregoing statement only holds true if the debtor firm as a forward-looking matter has a profitable business, on an income statement basis, letting financial bygones be bygones. Is this a viable enterprise? Does the firm make enough money to pay its current expenses and turn a profit? A horse-and-buggy company a hundred years ago, after the invention of the automobile, likely would not be worth saving. Today, many bricks-and-mortar retailers face the same fate in an Amazon/Walmart world.[10] Accordingly, as a cautionary note, it bears remembering that Chapter 11 is not justified for every business.[11]

For those businesses that are worth saving, however, simply saying that there is a going-concern surplus over liquidation value does not tell us why there should be a court-supervised rescue procedure in order to capture that going concern surplus.[12] Firms avoid filing bankruptcy and do workouts and restructurings all the time—so why not just always rely on out-of-court workouts and avoid the costs and hassles of Chapter 11?

The reason that a court-supervised proceeding is necessary is to solve the holdout problem.[13] The holdout problem does not raise its ugly head in every case, and when it does not, an out-of-court workout may—

---

6. Tabb, *supra* note 2, at 802.

7. CHARLES JORDAN TABB, THE LAW OF BANKRUPTCY 1035 (2016).

8. John D. Ayer, *Through Chapter 11 with Gun or Camera, but Probably Not Both: A Field Guide,* 72 WASH. U. L REV. 883, 890 (1994).

9. Tabb, *supra* note 2, at 804.

10. Phillip Michael, *E-commerce is Killing Retail, But Where Does That Leave Landlords, We Asked a Shopping App CEO,* BIGGER POCKETS (Oct. 18, 2020), https://www.biggerpockets.com/blog/ecommerce-killing-retail.

11. Rick Antonoff, *Out-Of-Court Debt Restructuring and the Problem of Holdouts and Free Riders*, CORP. COUNSEL. BUS. J (Mar. 3, 2019), https://ccbjournal.com/articles/out-court-debt-restructuring-and-problem-holdouts-and-free-riders.

12. Ayer, *supra* note 8, at 888.

13. *Id.*

and often does—happen.[14] Indeed, such restructurings out-of-court are quite common. But if a recalcitrant creditor or group of creditors presses the issue, the only way to avoid a massive waste of firm value through the potential destruction of the going-concern surplus is to stop all collection efforts and to bind dissenting creditors to the proposed restructuring.[15] That can only be done via a court procedure such as Chapter 11.[16] Outside of bankruptcy, creditors are free to try to collect and to levy on firm assets, and by doing so, potentially destroy going concern value.[17]

One of the first cases the author worked on long, long ago illustrates the problem. The client's entire business was servicing accounts for various customers, and to execute that core business, the client had to use a large computer server. Without its main computer, the client's business was effectively dead and valueless. A creditor got a large judgment against the client after a bitter and contentious trial and refused all pleas to accept payment over time or to work something out. The judgment creditor got a writ of execution issued and delivered to the sheriff, who showed up at the client's business intent on levying on the computer—which would put the client out of business. All going-concern value would be destroyed. The creditor essentially said, "Pay my judgment in full, or I'm seizing your computer and putting you out of business." At that point, the author had been dispatched to the bankruptcy clerk's office in Dallas, with the papers to file Chapter 11 in hand. When the sheriff knocked and made demand, the author filed. That filing of course triggered the automatic stay and stopped the sheriff's levy. The client's business, on a going-forward basis, was a healthy one, and the debtor firm was able to confirm a reorganization plan—over the dissent of the recalcitrant judgment creditor, who of course was bound to the terms of the confirmed plan—and keep the client's business alive, with going-concern value captured. All creditors got a substantial percentage return on their debts.[18]Without Chapter 11 (or something like it), everyone, except the holdout creditor seeking to levy, would have been wiped out and gotten nothing.

Another example of this value-maximization/holdout paradigm is from the Supreme Court's 1983 decision in *United States v. Whiting*

---

14. *Id.*
15. Antonoff, *supra* note 11.
16. *Id.*
17. Ayer, *supra* note 8, at 888.
18. This information is a reflection of the author's past, personal experience with a specific matter. Any details and specifics concerning this case are based upon the author's own knowledge.

Pools, Inc.[19] According to the Court, the uncontroverted facts included the following:

> Respondent Whiting Pools, Inc., a corporation, sells, installs, and services swimming pools and related equipment and supplies . . . Whiting owed approximately $92,000 in . . . taxes . . ., but had failed to respond to assessments and demands for payment by the IRS. As a consequence, a tax lien in that amount attached to all of Whiting's property.
>
> On January 14, 1981, the Service seized Whiting's tangible personal property—equipment, vehicles, inventory, and office supplies—pursuant to the levy and distraint provision of the Internal Revenue Code of 1954. According to uncontroverted findings, *the estimated liquidation value of the property seized was, at most, $35,000, but its estimated going-concern value in Whiting*'s hands was $162,876.[20]

In sum, absent some mechanism, such as Chapter 11, to reverse and counter the negative consequences of the IRS's asset seizure, over a hundred thousand dollars in value would have been lost. Indeed, the unilateral action of the IRS would have destroyed $70,000 in value for the residual stakeholders in the firm—the unsecured creditors and the owners of the firm—even though they came in line after the IRS.[21] With Chapter 11, though, and the asset turnover the Supreme Court ordered, the IRS lien position could be fully protected, while allowing the business to capture the sizable difference in going concern value and liquidation value.[22] Outside of bankruptcy, though, there was no legal remedy to unwind the IRS's destructive seizure.[23]

To recap point one, then, a bigger pie is better than a smaller pie, and something like Chapter 11 may be necessary to stop hungry creditors from eating up what little pie is left, or even just throwing the pie in the garbage.

B. Equitable Distribution of Firm Value

The second major normative goal of Chapter 11 is to distribute or allocate the value of the firm in a fair and equitable way among the stakeholders in the enterprise. Continuing with the pie metaphor, no stakeholder in the firm should be allowed to get more than its fair share

---

19. 462 U.S. 198, 199 (1983).
20. *Id.* at 199–00 (emphasis added).
21. *Id.* at 211.
22. *Id.* at 211–12.
23. *Id.* at 212.

of whatever pie there is.[24] Nor should they be allowed to take someone else's piece of pie and give it to a friend or, perhaps more accurately, to a fellow pie-grabbing conspirator. What constitutes anyone's "fair share" normally should be judged against relative non-bankruptcy priority distributional entitlements.[25]

This distributional norm is critical. History has demonstrated that when a business becomes insolvent or approaches insolvency, creditors and equity holders with leverage strive mightily to cut out some stakeholders and increase their share, or, at the very least, act with indifference to the distributional entitlements of other stakeholders.[26]

This inequitable distribution can be manifested in various ways, both in terms of horizontal inequality and vertical inequality. That is, horizontally, without Chapter 11, creditors of similar rank may get a bigger share than their equivalent compatriots.[27] Vertically, some claimants higher up the food chain may get too much, or those down the ladder may jump over higher ranked parties.[28]

Examples of all of these types of inequalities abound. Consider again the facts of the *Whiting Pools* case just discussed. Without the intervention of Chapter 11, the IRS as a secured creditor would get paid something, whereas unsecured creditors would get *nothing*—even though there was going-concern value of $70,000 over and above the IRS lien that could have been used to pay junior creditors and equity—and which, in fact, was so used once Chapter 11 was commenced and turnover of the seized assets was ordered.[29]

Or take a simple and common type of case, where one unsecured creditor gets a judgment and levies execution against an insolvent debtor, leaving nothing for other similarly situated unsecured creditors.

Or consider the famous 1913 Supreme Court case of *Northern Pacific Railway Co. v. Boyd,*[30] which announced the still-controlling doctrine for the "fair and equitable" absolute priority rule.[31] Recall the facts of that case. The mortgagees, who were indisputably first in line, cut a sweetheart deal with the company's controlling inside equity holders, who were indisputably last in line, whereby the equity holders

---

24. Charles J. Tabb, *Bankruptcy and Entrepreneurs: In Search of an Optimal Failure Resolution System*, 93 AM. BANKR. L.J. 315, 319–20 (2019).

25. *Id.* at 329.

26. *Id.* at 316–17.

27. *Id.* at 317.

28. *Id.*

29. United States v. Whiting Pools, Inc., 462 U.S. 198, 211–12 (1983).

30. 228 U.S. 482, 509 (1913).

31. *Id.* at 508.

would keep a share in the reorganized railroad, but the unsecured creditors—including our hero, Joseph Boyd—would get nothing, even though they ranked ahead of the equity holders.[32] The Supreme Court was not having it, and said if there is any value in the firm, it had to go to Boyd and his fellow unsecured creditors, before the bottom-of-the-barrel equity holders could take anything.[33]

As this Article will discuss in the "what's wrong with Chapter 11" section, one of the single biggest failures of Chapter 11 in its current state is in this distributional fairness area. Give ups, critical vendor orders, and roll ups, for example, are all ways in which the equitable distributional norm is being trampled on a daily basis.

C. Save Jobs

A third major justification for Chapter 11 is to save jobs. Obviously, if a General Motors, or Chrysler, or United Airlines failed and went out of business, tens or even hundreds of thousands of jobs would be lost. The harm to the out-of-work employees themselves is of course manifest. And the ripple harm throughout the economy would be devastating as well—especially in local communities where large concentrations of laid off employees no longer will have money to buy cars, or make house payments, and so forth. Imagine the impact in Seattle if Boeing failed.[34] There, 80,000 people work for Boeing—that is over one out of every fifty people in the greater Seattle area.[35]

At the same time, though, it is important to be careful not to overstate the jobs point. Remember saving firms that are savable, that is, that have a viable ongoing business.[36] For instance, if quantum physicist's perfect teleportation, then Boeing is not worth saving. Why fly on a plane when you can just teleport? Or, on a more mundane and more realistic level, recall the point about horse and buggy businesses being replaced a century ago by the automobile.

---

32. *Id.* at 499.

33. *Id.* at 508.

34. Dominic Gates, *For the First Time in Six Years, Boeing Employment Grows,* SEATTLE TIMES (Feb. 8, 2019), https://www.seattletimes.com/business/boeing-aerospace/for-the-first-time-in-six-years-boeing-employment-grows/.

35. *See* Jonathan Pfeffer, *Top 10 Employers in Seattle*, METROMBA (Dec. 6, 2016), https://www.metromba.com/2016/12/top-10-employers-in-seattle/.

36. *See* Jacob Silverman & Ed Grabianowski, *How Bankruptcy Works*, HOWSTUFFWORKS, https://money.howstuffworks.com/personal-finance/debt-management/bankruptcy2.htm (last visited Mar. 28, 2021).

And along the same lines, even if some jobs become unnecessary and anachronistic, it is certainly possible that those displaced employees could get new jobs with new businesses. A century ago, there were not 80,000 aircraft manufacturing jobs in Seattle—or anywhere—because Orville and Wilbur Wright had not yet figured out how to fly.[37] The displaced horse and buggy employees could look to the opportunity of hundreds of thousands of new jobs in the automobile industry. If teleportation becomes feasible, there will surely be many new jobs in that field.

D. Minimize the Ripple Effect of Failure

A fourth justification for Chapter 11 is that saving a viable business does not impact just that business. The economy is interconnected. By definition, firms are connected in a web of contracts with other firms.[38] For virtually every business, its salvation or failure will trigger externalities.[39] If a business fails, those other firms that did business with the failed firm are hurt; they have lost a customer.[40] Stated otherwise, the failure of a firm can have a ripple effect throughout the economy.[41] The bigger the firm, the more dramatic and cataclysmic the ripple effect.

Think about the auto cases for a moment. What if General Motors (GM) and Chrysler had failed? Their collapse would have caused the failure of thousands of other firms dependent on the big autos. Dealerships, gone. Auto parts suppliers, dead on arrival. The list goes on and on.

But once again, it is important not to overstate the point. If a ship is sinking, bailing water with buckets is a doomed fool's errand. It just won't work. If it's going to sink, it's going to sink.

And as with the jobs point, even if a major firm fails, there is no reason to think that substitutes will not take the place of the failed firm and assume that position in the interconnected economy. When the author was a youngster, nearly everybody drove either a GM car or a Ford. "Foreign" cars were rare; maybe the cool guy on the block drove an Aston Martin, or the frugal old couple drove a Volvo, but those were exceptions. Now, of course, foreign cars are ubiquitous in the United States. They're hardly even thought of as "foreign" cars. And if GM or Chrysler had

---

37. *First Airplane Flies*, HISTORY (Dec. 17, 2019), https://www.history.com/this-day-in-history/first-airplane-flies.

38. *See* Efraim Benmelech et. al., *The Agglomeration of Bankruptcy*, 32 REV. OF FIN. STUD. 2542, 2542 (2018).

39. *See id.* at 2584.

40. *See id.* at 2582.

41. *See id.* at 2542.

failed, there is no reason to think that Volkswagen, and Honda, and Toyota would not have moved to fill the void.

E. The Cure is Not Worse than the Disease

To review, Chapter 11 is desirable if it can maximize a debtor's value and capture the going-concern surplus, distribute that value fairly, save jobs, and prevent a ripple contagion of failure throughout the economy. These are all desirable goals.

But everything has a price. And any action taken has repercussions and consequences. Are the benefits of Chapter 11 worth the price we pay, both in terms of direct costs and indirect costs? Or, to use another metaphor, we have to be sure that the cure is not worse than the disease.

There is reason to be concerned that Chapter 11 currently fails this test. Debtor management often appears to think so, because one of the major problems today is firms trying to avoid filing Chapter 11 if at all possible, and indeed waiting until it is too late to salvage the situation.[42] The reformers of the 1970s tried to craft Chapter 11 so that debtor management would not be unduly wary to take the Chapter 11 plunge, but we may again be in just that predicament.[43]

What are some of the concerns?

One concern, of course, is the direct cost. Chapter 11 costs a fortune.[44] Consider the earlier United Airlines example. Lots of jobs were saved. Hurray! But the direct costs in terms of fees? Just a third of a billion dollars![45] However you slice it, that's a lot of money. It's a good deal if you're a lawyer or accountant or turnaround specialist and get in on the largesse, but it's bad for pretty much the rest of the world. Not to throw stones, but did those professionals really add a third of a billion dollars in value?

A second major concern about Chapter 11 as it exists today is that bank lenders have effectively captured the process.[46] As this Article will discuss, DIP financing today has become a vehicle for self-enrichment for controlling lenders.

---

42. *See* ABI REPORT, *supra* note 4, at 12, 12 n.46 (citing Michelle M. Harner & Jamie Marincic Griffin, *Facilitating Successful Failures*, 66 FLA. L. REV. 205, 207–08 (2014)).

43. *See* ABI REPORT, *supra* note 4, at 10–11.

44. *See* Kenneth A. Rosen, *What Does Chapter 11 Really Cost?*, BLOOMBERG (Apr. 20, 2016, 3:26 PM), https://news.bloomberglaw.com/bankruptcy-law/what-does-chapter-11-really-cost (discussing the various fees associated with filing Chapter 11).

45. *See United Runs $335 Million-Plus Bankruptcy Tab*, NBC NEWS (Mar. 9, 2006, 4:19 PM), https://www.nbcnews.com/id/wbna11748205.

46. *See* David A. Skeel, Jr., *Doctrines and Markets: Creditors' Ball: The "New" New Corporate Governance in Chapter 11*, 152 U. PA. L. REV 917, 918–19 (2003).

Third, the push and pull toward distributional inequality is worse than ever. Those enjoying leverage over the process get paid more, much more, than others who lack similar clout.[47] Think "critical vendors" and "DIP lenders" here, as the Article will explain below.

A fourth concern is whether the supposedly "soft landing" of Chapter 11 has skewed the operational and financial decisions of debtor management in advance of a Chapter 11 case, knowing that if they will be able to offload some of the negative consequences of failure onto third parties through the Chapter 11 process.[48] That is, the worry is that firms do not fully internalize the downsides of decisions they make, leading them to operate in a suboptimal inefficient manner. Stated in fancier lingo, the allegation is that sometimes a firm's descent into Chapter 11 is more endogenous than exogenous.

That the endogeneity charge is legitimate raises some skepticism. Indeed, the current unattractiveness of Chapter 11, which this Article will discuss in just a moment, contradicts that narrative. If Chapter 11 is so wonderful, why do firms try to avoid it like the plague?

But there is no denying that if we make Chapter 11 more attractive than it currently is, then rational debtor managers could and indeed probably should factor in the "soft landing" benefits of Chapter 11 when making business decisions.[49] It's a bit of a catch-twenty-two; if we make Chapter 11 attractive and workable, then those Chapter 11 benefits would allow a debtor to offload some of the costs of failure, thus leading possibly to inefficient investment decisions prior to bankruptcy.[50]

A final worry about the downsides of the Chapter 11 cure—if the cure itself is efficacious—is that it might postpone the necessary and, at some point, inevitable culling out of weak firms with an unprofitable core business. In the meantime, during the delay, unrecoverable costs will be incurred, and potentially superior redeployments of assets may be foregone. Chapter 11 cannot change macroeconomic realities.

Let's return to today's bricks-and-mortar retailers in America. In an Amazon and Walmart dominated world, the larger business reality for many of those retailers is that they have no realistic long-term hope of success.[51] Better, then, to deal with that unavoidable reality sooner rather

---

47. *See* David A. Skeel Jr., *The Past, Present and Future of Debtor-in-Possession Financing*, 25 CARDOZO L. REV. 1905, 1906 (2004).

48. *See* Paul Povel, *Optimal "Soft" or "Tough" Bankruptcy Procedures*, 15 J. OF L. & ECON. 659, 659 (1999).

49. *See id.*

50. *See id.*

51. *See* Adam Robinson, *The Amazon Effect is the New Walmart Effect,* CERESIS, https://cerasis.com/walmart-effect/ (last visited Oct. 24, 2020).

than later. No reason to throw good money after bad. Sure, as a parent of four millennials, it made me sad to watch Toys-R-Us die;[52] that was a big part of my kids' childhoods. But the sad truth was that there was no hope for Toys-R-Us. Of course, Toys-R-Us is now trying to be resurrected from the dead.[53] Good luck with that. Is the same true for Sears? Was "saving" Sears in Chapter 11 really worth trying? Or is it just postponing the inevitable?

II. THE NIGHTMARE: WHAT CHAPTER 11 IS

This brings us to this Article's central theme: what is wrong with Chapter 11? What are the central problems facing us given the reality of Chapter 11 today, especially as weighed against the normative ideals of what it could be? After discussing the big problems, the final part of this Article will mention a few possible solutions to those problems.

This Article cannot describe in detail all the possible issues with Chapter 11 practice today. This Article will discuss five major problems. First, most fundamentally, at some level, traditional Chapter 11 reorganizations no longer exist, which is a pretty basic problem. What's wrong with Chapter 11? There is no Chapter 11! It isn't that Chapter 11 has been repealed, of course. Rather, it's just been replaced in practice. In its stead, there are predominantly what my coauthor Ralph Brubaker and I have called "Chapter 3" reorganizations, i.e., a significant percentage of restructurings are now done through all-asset § 363 sales.[54]

Second, and related to the first point, it is a secured creditor's world now. In many cases, secured lenders effectively have captured and now control the reorganization process and take much—*too* much, many think—of the reorganization value flowing therefrom,[55] through a

---

52. *See* Nathan Bomey, *5 Reasons Toys R Us Failed to Survive Bankruptcy*, USA TODAY (Mar. 18, 2018, 1:35 PM), https://www.usatoday.com/story/money/2018/03/18/toys-r-us-bankruptcy-liquidation/436176002/.

53. *See Toys"R"Us Emerges with New Vision, Team & Global Strategy*, TRU KIDS BRANDS (Feb. 11, 2019), https://www.prnewswire.com/news-releases/toysrus-emerges-with-new-vision-team—global-strategy-300792831.html#:~:text=11%2C%202019%20%2FPRNewswire%2F%20%2D%2D,iconic%20brands%20around%20the%20world.&text=The%20company%20also%20appointed%20brand,on%20global%20strategy%20and%20execution.

54. *See, e.g.*, Ralph Brubaker & Charles J. Tabb, *Bankruptcy Reorganizations and the Troubling Legacy of Chrysler and GM,* 2010 U. ILL. L. REV. 1375, 1378 (2010); *see also* ABI REPORT, *supra* note 4, at 201–06 (the ABI Report calls these "363x sales"); TABB, *supra* note 7, at 452–59.

55. *See* Charles J. Tabb, *The Bankruptcy Clause, The Fifth Amendment, and the Limited Rights of Secured Creditors in Bankruptcy,* 2015 U. ILL. L. REV. 765, 768–70 (2015). Jay Westbrook, however, challenges the veracity of this "secured creditor control" story as an

combination of two basic plays, neither of which was common when the Bankruptcy Code became effective forty years ago.[56] Specifically, first, prior to bankruptcy, the secured lender gets comprehensive blanket liens on virtually all of the debtor's assets, so everything in the estate is encumbered entering bankruptcy.[57] Second, in bankruptcy, the secured lender enjoys generous—or perhaps a better word, depending on your perspective, is draconian—DIP financing terms.[58]

Third, building on, but not limited to, the second point, the value in the debtor firm is not distributed fairly, on either a horizontal or vertical equity basis. Instead, certain parties with leverage get more than they should, and others get less, if anything at all.

Fourth, a virtually unlimited venue choice has led to race-to-the-bottom forum shopping.[59]

Fifth and last, and related to the forum shopping point, many bankruptcy courts—and especially those in the most-selected venues—write their own bankruptcy law through an extreme and excessive invocation of the all-writs equity power in § 105(a).[60] It's almost like this is back in the judicially dictated full-discretion equity receivership world,

---

empirical matter. *See* Jay Lawrence Westbrook, *Secured Creditor Control and Bankruptcy Sales: An Empirical View,* 2015 U. ILL. L. REV. 849, 849–50 (2015).

A symposium on Chapter 11 Reform was conducted in Chicago, Illinois, in April 2014 by the University of Illinois College of Law in conjunction with the American Bankruptcy Institute's Chapter 11 Commission, focusing primarily on the rights and entitlements of secured creditors in bankruptcy, and the articles were published in Volume 2015 of the *University of Illinois Law Review* at pages 507–863. *See* Ralph Brubaker, Robert M. Lawless & Charles J. Tabb, *Reforming Chapter 11 Bankruptcy Reorganizations,* 2015 U. ILL. L. REV. 507, 507 (2015); ABI REPORT, *supra* note 4, at 16. For recordings of those presentations *see ABI Illinois Symposium on Chapter 11 Reform*, AM. BANKR. INST., http://commission.abi.org/April-05-2014 (last visited Feb. 27, 2019).

Several of the articles in that Symposium questioned the appropriateness of allowing secured creditors to capture all, or the bulk, of the going-concern surplus as part of their lien rights. *See, e.g.*, Michelle M. Harner, *The Value of Soft Variables in Corporate Reorganizations,* 2015 U. ILL. L. REV. 509, 514–15 (2015); *see* Edward J. Janger, *The Logic and Limits of Liens*, 2015 U. ILL. L. REV. 589, 592 (2015); *see* Charles W. Mooney, Jr. *The (Il)Legitimacy of Bankruptcies for the Benefit of Secured Creditors,* 2015 U. ILL. L. REV. 735, 750–51 (2015); Tabb, *supra*, at 768–70; *cf.* Barry E. Adler, *Priority in Going-Concern Surplus*, 2015 U. ILL. L. REV. 811, 813 (2015). For a thoughtful, balanced, and nuanced view of the entire issue *see* Douglas G. Baird, *The Rights of Secured Creditors After Rescap*, 2015 U. ILL. L. REV. 849, 849–50 (2015).

56. *See* ABI REPORT, *supra* note 4, at 10–11.

57. *See id.* at 12, 12 n.43.

58. *See id.* at 67–79.

59. The most prominent critic of the forum shopping phenomenon is Lynn LoPucki. *See, e.g.*, Lynn M. LoPucki, *COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS 245–51* (2005).

60. *See* ABI REPORT, *supra* note 4, at 254–55.

except for the mild inconvenience that Congress did pass a Bankruptcy Code that courts are supposed to apply.

In addition, there are two other commonly expressed concerns about Chapter 11. Space, however, does not permit me an in-depth discussion. Sixth, Chapter 11 costs too much—as noted earlier in mentioning as an illustration the third of a billion dollars in fees in the United Airlines case.[61] Seventh, firms wait too long to seek Chapter 11 relief—in part because of the cost concern just noted—if they even seek that relief at all.[62]

A. Goodbye Traditional Chapter 11s: It's all About § 363 Sales Now

An old-fashioned, sit-down-and-negotiate-a-plan Chapter 11 reorganization just doesn't happen much anymore. Traditional Chapter 11 has gone the way of the rotary phone. Now, the name of the game is to do a § 363 sale of all the assets, and in effect, to borrow from the title of a classic old Woody Allen movie, "take the money and run."[63] Not *every* case is done via a sale, but it has become the norm.

The evolution of the all-asset sale paradigm presents an interesting, and common, illustration of how legal practice and accompanying doctrines develop. In a sense, it is a typical "camel's nose under the tent" situation. Some of the first major cases to approve all-asset sales prior to a reorganization plan did so because the alternative effectively was to lose much of the reorganization value if the sale had to wait, because of some unavoidable external exigency.[64] For example, one of the first cases to approve such a sale did so to take advantage of the boost in holiday Christmas sales for a stock of handkerchiefs.[65] Another case approved a sale of a skeletal building under construction to Holiday Inn in time for the 1964 New York World's Fair, which was in the proximity.[66] In time, though, this notion of a pressing need to capture more value *now* gave way to a more generous and less demanding "good business reason" test, first announced by the Second Circuit in the *Lionel* case.[67] Seemingly forgotten is the Second Circuit's further statement in *Lionel* that "we also reject the view that § 363(b) grants the bankruptcy judge *carte*

---

61. *See id.* at 12, 12 n.44, 56–59.
62. *See id.* at 12, 12 n.46, 20, 20 nn.72 & 74.
63. *See Take the Money and Run*, IMDB, https://www.imdb.com/title/tt0065063/ (last visited Mar. 3, 2019).
64. *See In re* Pedlow, 209 F. 841, 842 (2d Cir. 1913).
65. *See id.*
66. *See In re Sire Plan, Inc.,* 332 F.2d 497, 498 (2d Cir. 1964).
67. *In re* Lionel Corp., 722 F.2d 1063, 1071 (2d Cir. 1983).

blanche."[68] *Carte blanche*, though, is a pretty accurate description of where we are now. I cannot recall a case in recent years where the bankruptcy judge rejected the idea of a § 363 all-asset sale because no sufficient justification to sell *now* had been given. The question usually isn't even asked, and if it were, no one would care what the answer was.

So, two questions: "why has this happened" and "should we care"? First, on the "why has this happened" point, the most common reason is that the party putting up the money to fund the reorganization insists on a sale.[69] Second, the putative stalking horse buyer insists on a § 363 sale, to grease the wheels and get to the finish line more quickly and with less hassle, and to take advantage of the glorious safe harbor of § 363(m).[70]

A sale gives the lender more control over the nature and terms of the reorganization, gets them in and out of bankruptcy much faster and more cheaply, and immunizes them and the buyer from collateral attack.[71] Even more troubling, the current practice typically allows the controlling parties to dictate distributions of the sale proceeds, even in ways that might contravene Chapter 11 norms.[72] In the *GMC* case, for example, the United States government was able to divert an unequal amount of the firm's value to labor unions in preference over other similarly situated creditors, without having to comply with any of Chapter 11's rules that might permit such an inequality, but only upon satisfaction of rigorous justificatory standards.[73]

The most famous § 363 sales ever, by far, were the auto cases—GM and Chrysler—a decade ago.[74] At just over a month each, those cases were effectuated in lightning speed and went through the § 363 sale process in large part for the very simple reason that the U.S. government, which was putting up most of the money, insisted on it.[75]

So, too, in much more mundane cases, the controlling pre-bankruptcy secured lender demands a § 363 sale, at which either the property is sold free and clear to a pre-arranged bidder, or, at worst, at

68. *Id.* at 1069.

69. *See* Scott Opinkar, *2 Approaches to the Sale of Assets in Liquidating Chapter 11 Cases*, MCDONALD HOPKINS (July 7, 2017), https://mcdonaldhopkins.com/Insights/Blog/Restructuring-Strategies/2017/07/07/2-approaches-to-the-sale-of-assets-in-liquidating-Chapter-11-cases.

70. *See* 11 U.S.C. § 363(m) (2021).

71. *See* ABI REPORT, *supra* note 4, at 72, 84, 135.

72. *See* Brubaker & Tabb, *supra* note 54, at 1379.

73. *See id.* at 1401–05.

74. *See id.* at 1377.

75. Kevin Krolicki & John Crawley, *GM Files for Bankruptcy, Chrysler Sale Cleared*, REUTERS (May 31, 2009, 7:35 PM), https://www.reuters.com/article/us-gm/gm-files-for-bankruptcy-chrysler-sale-cleared-idUSN3044658620090601.

which the secured lender can protect itself via credit bidding under § 363(k).[76] That secured lender is only willing to put up enough DIP financing money to get the case through the sale. And, as will be explained under the next criticism of Chapter 11, given the pre-bankruptcy secured lender's blanket liens, no other lender realistically can do the DIP financing.

Should we care about the shift from traditional Chapter 11 reorganizations to § 363 sales? Yes. We should care a lot. The move to § 363 sales has trampled on, indeed arguably has eviscerated, both the procedural and the substantive protections afforded to stakeholders under the Chapter 11 plan confirmation regime.

The concerns are as described in the author's treatise:

> Two related concerns arise when a debtor sells all or substantially all of its assets through a § 363 sale, one procedural and one substantive.
>
> The procedural concern is that the debtor is attempting to dispose of its assets and fix the payment to creditors without a formal disclosure statement, plan, ballot, or meaningful opportunity for creditors to participate in the bankruptcy process, other than by appearing at a court hearing and complaining. In short, debtors might use a § 363 sale to circumvent the more stringent and time-consuming procedural requirements of the chapter 11 plan confirmation process.
>
> On the substantive side, the worries are first, that this may not be the best deployment of the debtor's assets, and second, that the "sale" will subvert distributional entitlements.
>
> The first concern (deployment) is less problematic than the second (distribution), and might well be manageable in a sale setting.
>
> However, even if a prompt sale is the most efficient and value-enhancing way of deploying the debtor's assets, and even if the judge can make that determination wisely at a sale hearing, that deployment choice should not be allowed to bleed over into the "who gets what" question—but it often does.
>
> How to make the pie the biggest and who gets how big a slice are critically different questions.
>
> Regardless of how a company disposes of its property—whether by plan or sale—courts should keep their primary focus on the need to preserve distributional norms and the entitlements of stakeholders.[77]

---

76. *See* Charles J. Tabb, *Credit Bidding, Security, and the Obsolescence of Chapter 11*, 2013 U. ILL. L. REV. 103, 104–06 (2013).

77. TABB, *supra* note 7, at 1094.

Unfortunately, after the auto cases, a situation exists where courts do not insist on preserving distributional norms in sale cases.[78] Indeed, in both cases, the bankruptcy judges concluded that "[t]he allocation of ownership interests in the new enterprise is irrelevant to the estate's economic interests,"[79] and in *GMC* the judge observed that "the purchaser was free to provide ownership interests in the new entity as it saw fit."[80] Adding insult to injury, such "free allocations" apparently can now be approved under the capacious "good business reason" test of *Lionel*.[81]

This is a dangerous path to tread, and resurrects the fallacy rejected over a century ago by the Supreme Court in *Northern Pacific Railway Co. v. Boyd*[82] and other foundational equity receivership cases that laid the groundwork for the "fair and equitable" test of absolute priority.[83] The Court in *Boyd* refused to let the purchaser dictate the allocation of ownership interests, recognizing instead that the value to the purchaser was equivalent to the value of the debtor's estate, and to let the purchaser dictate distributions that contravene absolute priority entitlements would violate the rights of the creditors of the debtor firm.[84] In the earlier *Louisville Trust* case, the Court accurately recognized that to take from Peter to pay Paul as a condition of the supposed sale "deserves the condemnation of every court" and "involves a temptation [for] . . . the purchase price to be paid . . . in fact by the unsecured creditor"[85] whose rightful share is being diverted to others.

Even more disturbing is that in these sale cases, the courts do not even recognize the *sub silentio* overruling of *Boyd*.[86] Taking the sale route, instead of the plan route, now apparently frees the controlling parties from the inconvenient strictures of the absolute priority rule.[87] This may be one of the most, if not *the* most, central threats to the integrity of bankruptcy reorganizations today.[88] Those parties who control the

---

78. *See* Brubaker & Tabb, *supra* note 54, at 1379.

79. *Id.* at 1402 (quoting *In re* GMC, 407 B.R. 463, 497 (Bankr. S.D.N.Y. 2009) (internal quotations omitted)).

80. *Id.* (quoting *In re GMC*, 407 B.R. at 497).

81. *In re* Lionel Corp., 722 F.2d 1063, 1071 (2d Cir. 1983).

82. *See* N. Pac. Ry. Co. v. Boyd, 228 U.S. 482, 510 (1913); *see* Brubaker & Tabb, *supra* note 54, at 1402.

83. *See* Brubaker & Tabb, *supra* note 54, at 1402.

84. *See* 228 U.S. at 508.

85. Louisville Trust Co. v. Louisville, New Albany & Chi. Ry. Co., 174 U.S. 674, 688 (1899); *see* Brubaker & Tabb, *supra* note 54, at 1402–03.

86. *See generally In re Lionel Corp.*, 722 F.2d at 1066 ("the trustee, after notice and hearing, may use, sell, or lease property of the estate other than in the ordinary course of business.").

87. *See* Brubaker & Tabb, *supra* note 54, at 1392.

88. *See id.* at 1406.

process can dole out reorganization value to whomever they see fit, with no constraints whatsoever, except perhaps an almost nonexistent "good business reason" explanation.[89]

B. Secured Lenders Rule & Get It All

Speaking of control, the second point of concern about Chapter 11 today is that almost everything goes to the pre-bankruptcy secured lender.[90] They call all the shots and capture all of the reorganization value up to the amount needed to pay themselves off.

This development is partly attributable to and the fault of changes in non-bankruptcy financing, a pro-creditor rewriting of article 9 about twenty years ago, misguided views about what adequate protection requires, as well as the correct valuation for cram down, and DIP financing terms and practices that further feather the secured lender's nest.

The first significant point is that today—unlike when the Code was written forty years ago—debtor firms often have all of their assets encumbered by their pre-bankruptcy secured lender. Accordingly, when the debtor firm enters bankruptcy, it does so with no unencumbered assets.[91] The secured lender has a lien on everything, both now and in the future through after-acquired property clauses.[92]

What does that mean for a debtor in Chapter 11? What it means, first and foremost, is that no other lender realistically can or will do the DIP financing.[93] Why not? There are no free assets on which the new lender can rely for repayment, other than assets that might, perhaps, be generated during the case. Even assuming that § 552 can effectively cut off the pre-bankruptcy lender's floating liens in assets generated during the Chapter 11, it is hard to persuade a new lender to play ball without any *current* unencumbered assets to look to.[94]

---

89. *See id.* at 1406–07.

90. John D. Ayer et al., *What Every Unsecured Creditor Should Know About Chapter 11*, AM. BANKR. INST. J., (Mar. 3, 2019), https://www.kirkland.com/siteFiles/kirkexp/publications/2398/Document1/Friedland_What_unsecured_creditor_should.pdf (secured creditors are in a superior position, whereas unsecured creditors may be viewed as having the most to lose).

91. *See, e.g.*, ABI REPORT, *supra* note 4, at 70, 70 n.280.

92. *See generally* Brubaker & Tabb, *supra* note 54 (secured creditors are generally entitled to full value of collateral when debtor declares bankruptcy, sometimes to the exclusion of other important stakeholders).

93. *See* ABI REPORT, *supra* note 4, at 74.

94. *See* 11 U.S.C. § 552 (2021).

And getting a priming lien under § 364(d) is extraordinarily hard.[95] Think for just a moment about what you have to prove: first, that no one will do the financing without a priming lien, but also that the primed lender is adequately protected.[96] That is, in effect, the judge has to find that the primed lender is "adequately protected" by some package of security that no lender in the marketplace would voluntarily accept.[97] Tough sledding indeed.

Not only that, but it is common for prepetition inter-creditor or subordination agreements to preclude a prepetition junior secured lender from doing the DIP financing without the senior lender's consent, a provision which, if enforced, removes a possibly viable and willing DIP lender from the field.[98]

Even aside from the substantive difficulties of getting a new lender, a debtor might well have difficulty having the time or being able to persuade a putative new DIP lender to invest in the time and money to do the due diligence needed to get comfortable with making the DIP loan.[99] Not only that, the old lender may well have dictated to the debtor, whom it effectively controls through its blanket security, to file Chapter 11 as part of that old lender's overall plan to realize on its collateral. That is, lenders today use dictated Chapter 11 cases as a means of foreclosing on their collateral, while capturing a larger going concern premium instead of just the foreclosure value.[100]

That possibility stems in part, too, from the misguided view of courts that a secured creditor is entitled to realize, both as a matter of adequate protection and also for cram down, the *going concern* value of its collateral instead of just the *foreclosure* value.[101] I say misguided, because outside of bankruptcy, the secured creditor could only recover the foreclosure value of the collateral, by definition.[102] Any premium above that foreclosure value and which by definition is generated by the

---

95. *See* TABB, *supra* note 7, at 286.

96. *See* TABB, *supra* note 7, at 286; *see also* 11 U.S.C. § 364(d) (2021).

97. TABB, *supra* note 7, at 286.

98. *See* ABI REPORT, *supra* note 4, at 78–79.

99. *See* Bob Eisenbach, *DIP Financing: How Chapter 11's Bankruptcy Loan Rules Can Be Used to Help a Business Access Liquidity*, IN THE (RED) (Nov. 5, 2013), https://bankruptcy.cooley.com/2013/11/articles/business-bankruptcy-issues/dip-financing-how-chapter-11s-bankruptcy-loan-rules-can-be-used-to-help-a-business-access-liquidity/.

100. *See* Melissa B. Jacoby & Edward J. Janger, *Tracing Equity: Realizing and Allocating Value in Chapter 11*, 96 TEX. L. REV. 673, 707 (2018).

101. For criticism of that view, s*ee, e.g.*, Harner, *supra* note 55, at 540; Janger, *supra* note 55, at 614; Mooney, *supra* note 55, at 757; Tabb, *supra* note 55, at 765, 768–70; *cf.* Adler, *supra* note 55, at 812.

102. *See* Jacoby & Janger, *supra* note 100, at 686–87.

Chapter 11 case is in no way attributable to the secured creditor's collateral, but rather to the procedures and mechanisms of the bankruptcy case, and should not be allocated automatically to the secured creditor. Abandoning this erroneous view, which stems in part from the Supreme Court's *Rash* decision,[103] would go at least part of the way toward reducing the stranglehold secured lenders currently enjoy over the reorganization and the value generated therefrom.

As just noted, in many cases the pre-bankruptcy secured lender has a monopoly on the debtor's access to money. And it's safe to say that most businesses do need money to operate.

So, there is a monopolist: a monopolist over necessary working capital.[104] It's no surprise to learn, then—indeed it's an Econ 100 point—that the monopolist can extract monopolistic rents. And in Chapter 11 today, what do those monopolistic rents look like? They look like the DIP financing terms seen in so many cases, all of which give huge benefits to the DIP lender.[105]

What are some examples of these egregious DIP financing terms?[106] One common example is the "roll-up," or its sibling, cross-collateralization.[107] The basic effect of either is to convert the unsecured portion of a pre-bankruptcy lender's under secured claim to a secured claim in the bankruptcy, thus effectively preferring the lender's unsecured claim to those of all others unsecured creditors.[108] It is difficult to justify such a court-blessed preference; indeed, the author does not think the bankruptcy court even has the power to do so. But many courts feel otherwise, and roll ups continue to be granted as a matter of course, as long as the court does not feel the lender is being *too* greedy.[109] To paraphrase from the fictional Gordon Gekko in the movie *Wall Street*, apparently some "greed is good,"[110] or at least not illegal—just not too much.

---

103. *See generally* Assocs. Com. Corp. v. Rash, 520 U.S. 953 (1997) (in certain circumstances under a Chapter 13 bankruptcy plan where the debtor has exercised the cram down option, the creditor is entitled to the replacement value of property).

104. *See* Brubaker & Tabb, *supra* note 54, at 1392.

105. *See generally* Eisenbach, *supra* note 99.

106. *See* ABI REPORT, *supra* note 4, at 74–79.

107. *See* Charles Jordan Tabb, *A Critical Reappraisal of Cross-Collateralization in Bankruptcy*, 60 S. CAL. L. REV. 109, 110 (1986); *see also* ABI REPORT, *supra* note 4, at 77–78.

108. *See, e.g.*, Donald A. Jordan, *Cross-Collateralization in Chapter 11: Protecting the Small Business*, 40 WAYNE L. REV. 219, 219 (1994).

109. *Id.* at 236.

110. WALL STREET (Twentieth Century Fox 1987).

What's another amazing DIP financing goodie? Earlier this Article mentioned prohibitions on junior lenders doing DIP financing without the consent of the senior lender. This Article suggests that such clauses should not be enforceable. The parties to an agreement should not be able to hamstring a future reorganization. Doing so imposes an impermissible externality on all stakeholders in the debtor firm by restricting the prospects for effecting a reorganization in bankruptcy.[111]

Another common DIP goodie, or adequate protection provision, is a lien in favor of the secured lender on any recoveries from the successful exercise of part 5 avoiding powers.[112] The ABI Commission concluded that these liens on avoiding powers are indeed a bridge too far and interfere with the workings of a bankruptcy case for the benefit of all and should not be allowed.[113] This Article agrees.

Another plum? How about concessions as to the validity and enforceability of prepetition liens?[114] It's pretty nice to be able to whitewash and eliminate any challenges to the lender's prepetition secured position without any critical or searching examination or investigation into the merits, simply by offering some DIP financing money, which as explained earlier only that lender realistically can offer.[115] Or waivers and stipulations regarding § 506(c) surcharges and the 552(b) equities of the case exception?[116] The same charge could be made here.

Another whole set of problematic DIP terms concern milestones and benchmarks that require the debtor to take certain actions or satisfy certain conditions by specified deadlines, including, among other things, conducting an auction, closing a sale, or filing a disclosure statement or a plan.[117] These give the secured lender control over the entire case and its process, as a practical matter. This Article suggests that courts should not enforce these provisions. The bankruptcy court alone should be able to dictate such decisions. If the secured lender can enforce such terms, they control the case, and that's just not appropriate. A bankruptcy case should not be for sale.

In sum, this Article concludes that the present situation with regard to the power and control of secured lenders in reorganizations poses a

---

111. *See* Skeel *supra* note 46, at 919–20.
112. *See, e.g.*, ABI REPORT, *supra* note 4, at 72–73, 78.
113. *See* Skeel *supra* note 46, at 919–20.
114. See ABI REPORT, *supra* note 4, at 81.
115. *See id.*
116. *See id.*
117. *See id.*

huge problem. In the final section dealing with remedies, this Article will offer some suggestions for possible solutions.

C. Unfair & Inequitable Distribution of Value

This Article just discussed how pre-petition secured lenders often are able to use Chapter 11 to extract going concern value for their collateral, or to get paid preferentially on the unsecured portion of their prepetition claim, in either event reaping thereby an unwarranted windfall over and above the foreclosure value they could have gotten outside of bankruptcy.[118] This Article then argued that it is not appropriate for those secured creditors to capture that extra value or to get paid on their unsecured claim while other unsecured creditors are not paid.

But they hardly stand alone as culprits in the third problem this Article discusses, which is how value in Chapter 11 is not distributed fairly and equitably, in accordance with non-bankruptcy priority entitlements. A seemingly never-ending push in Chapter 11 is for some stakeholders to take more, leaving others with less, than they would receive if the case played out to the end without intervening preferential payouts, and instead everyone was left only to what they could insist on in a confirmed Chapter 11 plan.[119]

This Article's baseline position is that any and all such preferential or distribution-altering provisions should not be allowed—ever—whether at the time of exiting the case (as the Supreme Court held in *Jevic*[120]) or also on an interim basis during the case, because once paid, that's effectively final, whenever the payment may be. In virtually every instance, the driving impetus behind the distributional alteration is either, firstly, what amounts to extortion, or secondly, collusion.[121] Neither should be a basis for altering distributional rights, especially given the fact that Congress has passed a Bankruptcy Code that clearly spells out who gets what.[122]

Indeed, bankruptcy judges entering distribution-altering orders is one of the principal examples of the fifth problem this Article will soon discuss, that of unauthorized and excessive judicial legislation that rewrites the Code that Congress so inconveniently gave us.

Let's consider some examples of the types of distributional alterations to which this Article alludes. This Article won't rehash roll

118. *See, e.g.*, ABI REPORT, *supra* note 4, at 83–86.
119. Tabb, *supra* note 2, at 846.
120. Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 987 (2017).
121. *Id.* at 986–87.
122. *See generally* TABB, *supra* note 7.

ups and cross-collateralization for an under secured DIP lender, but those are classic examples. The net effect of either is for the unsecured portion of a creditor's claim to magically become secured during the case by judicial fiat, at the expense of other unsecured creditors who were not fortunate enough to have the leverage to demand security for their pre-bankruptcy unsecured claim.[123]

Structured dismissals are another example. Before the Supreme Court called foul on the practice in *Jevic*, lower courts would approve "dismissals" of a Chapter 11 case that provided for distributions of the bankruptcy estate in ways that altered the Code's distribution scheme.[124] While creditors could vote in a Chapter 11 plan to allow distributions of estate value in ways that vary from the Chapter 7 priority scheme, structured dismissals imposed such deviations even without the formal consent of the parties who were losing out.[125]

Courts rationalized such departures on the theory that the negatively affected parties often would not have gotten anything anyway, and thus that it would be better for at least some creditors to get paid something.[126] In effect, as this author's treatise states, the intuition was "that, in effect, half a loaf is better than none, even if just for some chosen few, and that those who would have starved anyway cannot complain that they are still starving while others feed at the trough."[127]

Prior to the Supreme Court's *Jevic* decision, the author argued that this "half a loaf" theory should be rejected, and pointed out that it is basically the exact same justification that the Supreme Court flatly rejected long ago in the *Boyd* case.[128] Remaining faithful to the "fixed principle" of absolute priority is the only sure way to guard against exactly the kind of collusion that was going on in the *Jevic* case, where the higher-ranking priority truck drivers were cut out of the deal because they would not play nice and go along.[129]

---

123. Seung Hee Cho, Roll-Up & Cross-Collaterization in DIP Financing as Measures of Creditor Control 6 (May 2018) (unpublished undergraduate thesis, Joseph Wharton Scholars Program, Wharton Business School) (on file with the University of Pennsylvania Scholarly Commons).

124. Charles Tabb, *Yes, Virginia, There is a Code Priority Scheme: Supreme Court Strikes Down Structured Dismissals In Jevic*, AM. BANKR. INST., at 1 (Mar. 23, 2017), https://www.abi.org/newsroom/bankruptcy-brief/commentary-yes-virginia-there-is-a-code-priority-scheme-supreme-court.

125. *Id.*

126. *Id.*

127. *Id.* at 2.

128. *Id.*

129. Tabb, *supra* note 124, at 2–3.

Fortunately, the Supreme Court held in 2017 in *Czyzewski v. Jevic Holding Corp.* that "[a] distribution scheme ordered in connection with the dismissal of a Chapter 11 case cannot, without the consent of the affected parties, deviate from the basic priority rules that apply under the primary mechanisms the Code establishes for final distribution of estate value in business bankruptcies."[130] In so holding, the Court effectively reaffirmed the basic premise of *Boyd*. Under *Jevic,* final distributions of value upon exit from a case simply cannot be approved by a bankruptcy court based on its own view of the equities of the situation.[131] The court lacks the power to do that, the Supreme Court concluded.[132] If a deviation in priority is to be made, it can be made *only* if the negatively affected parties consent pursuant to the carefully constructed procedures and safeguards for plan voting in Chapter 11.[133] If applied faithfully by lower courts, this is a monumentally important limitation on the power of controlling parties to divert value.

One scenario where the fundamental premise of *Jevic*, as well as that of *Boyd*, should dictate not allowing diversions of value is in inter-class gifting. In a gifting plan, the play is for a class that is senior to the dissenting class to "gift" part of their supposed value entitlement to a class that is *junior* to the dissenting class.[134] The argument in support is that the dissenting class cannot really complain because they would not have gotten that value anyway, if the senior class had just kept it.[135] So why should it matter to them if the senior gives it to someone else? It's almost an identical justification to that asserted in *Boyd* and also in *Jevic*. And the Supreme Court in *Boyd* (as well as in *Jevic*) rejected this "out of the money anyway" justification.[136]

That, this Article submits, is the right result, as well as that dictated by the Code's cram-down rules, as the Second Circuit properly held in the *DBSD* case.[137] Gifting should not be allowed.[138] If gifting were allowed, one problem is making an accurate judicial valuation of the debtor, because the only way to be sure the by-passed party is "out of the

130. Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 978 (2017).
131. *Id.*
132. *Id.*
133. *See id.*
134. *See, e.g.*, *Reports of the Demise of Gifting Chapter 11 Plans Are an Exaggeration*, JONES DAY (Dec. 2018), https://www.jonesday.com/en/insights/2018/12/reports-of-the-demise-of-gifting-chapter-11-plans/.
135. *Id.*
136. N. Pac. Ry. Co. v. Boyd, 228 U.S. 482, 505 (1913).
137. *In re* DBSD N. Am., Inc., 634 F.3d 79, 100–01 (2d Cir. 2011).
138. *See* TABB, *supra* note 7, at 1168–69.

money" is to fix an accurate valuation. The absolute priority "fixed principle" of *Boyd* obviates that need.[139]

Another major difficulty, which infects almost all of the judicially blessed value-reallocation stratagems, is "the knotty problem of distinguishing legitimate 'bargaining' from insider holdups."[140] As Professor Brubaker astutely observed:

> It is virtually impossible to penetrate the real reasons for the 'gift' to old equity: Is it really because they will provide substantial value to the reorganized entity, or is it simply because they have substantial control over the reorganization process, and a 'gift' to them is necessary to grease the reorganization skids?[141]

Even many § 363 sales may be suspect under the basic premise of *Jevic*, if they depart from bankruptcy priority rules on a final exit basis. In *Jevic*, the Court mentioned some of the sale cases (such as the Fifth Circuit's *Braniff* decision[142]) as exemplars of the idea that final distributions have to follow the Code scheme, and also distinguished and cited with approval the *Chrysler* case because it "demonstrated 'proper solicitude for the priority between creditors and deemed it essential that the [s]ale in no way upset that priority."[143]

Perhaps the most ubiquitous of value-reallocating practices in Chapter 11, as well as the most uncritically accepted as perfectly fine, are critical vendor orders. Under such an order, of course, the bankruptcy judge approves allowing the debtor to pay off—often on the first day of the case, in a commonly-called "first-day order"—the prepetition unsecured claims of trade vendors as to whom it is "critical" to the debtor's reorganization to keep that vendor's business.[144] Think Nike for a shoe retailer. The standard justification, as noted by the Supreme Court in *Jevic* musing in dictum that such interim orders might be okay, is "that the distributions at issue would 'enable a successful reorganization and make even the disfavored creditors better off.'"[145]

---

139. *See* Ralph Brubaker, *Taking Chapter 11's Distribution Rules Seriously: "Inter-Class Gifting is Dead! Long Live Inter-Class Gifting!,"* 31 No. 4 BANKR. L. LETTER 1, 11 (2011); *see also* Amy Timm, *The Gift that Gives Too Much: Invalidating a Gifting Exception to the Absolute Priority Rule*, 2013 U. ILL. L. REV. 1649, 1654 (2013).

140. *See* TABB, *supra* note 7, at 1169.

141. Brubaker, *supra* note 139, at 13.

142. *In re* Braniff Airways, Inc., 700 F.2d 935, 940 (5th Cir. 1983).

143. 137 S. Ct. at 986 (citing Ind. State Police Pension Trust v. Chrysler LLC, 576 F.3d 108, 118 (2d Cir. 2009)).

144. *See generally* Ayer, *supra* note 90.

145. Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 985 (2017) (first citing *In re* Kmart Corp., 359 F.3d 866, 872 (7th Cir. 2004)).

This Article disagrees with this apology for critical vendor orders. It argues instead that critical vendor orders are not permissible and indeed assert that bankruptcy courts lack the power to approve such preferential priority-deviating payments.[146] The equitable power of bankruptcy judges does not extend to empowering them to say "Pay A before B."

Even if judges had the power to in effect award priority, which they do not, it's a bad idea. In effect, cutting through the legal jargon, what's going on is that the bankruptcy court is caving in to either extortion or collusion.[147] Neither is admirable. How so extortion? The test usually requires that the affected creditor has the power if it takes its toys and goes away to severely hurt the chances of reorganization, and thus effectively says, "Pay me off or I'll kill the reorganization." And this from a creditor whom the debtor would be willing to pay up front, in cash, for new shipments.[148] And if not extortion, then its collusion—the debtor management wants to feather the nest of a vendor it wants to keep happy.

To justify such orders as only "interim" and as promoting reorganization and making even disfavored creditors better off is misguided. Interim or not, the reality is that even at the end of the case, when the final reckoning is made, the "critical" vendors will have gotten paid in full while the non-critical vendors likely only get cents on the dollar.[149] Recall in *Kmart*[150] that the "critical" vendors (all 2,330) got paid in full and the disfavored ones would have gotten but a dime on the dollar.[151]

And to say the dime-only creditors are "better off" begs the question of "in comparison to what?" Assume we lived in a world (a world for which this author would advocate) in which critical vendor orders were illegal in all circumstances. No power at all for the court to approve. In effect, we then would call the supposedly critical vendor's bluff. "We can't pay off your pre-bankruptcy unsecured claim. You really won't make new sales to us even for cash?" It's hard to imagine that in most cases the vendor would not go ahead and make the sale. Then the "disfavored" creditors are *not* disfavored but still get a share of the enlarged reorganization pie. But, as noted earlier in discussing inter-class

---

146. *See, e.g.*, Charles Jordan Tabb, *Emergency Preferential Orders in Bankruptcy Reorganizations,* 65 AM. BANKR. L.J. 75, 82 (1991); TABB, *supra* note 7, at 1082.

147. Tabb, *supra* note 146, at 78.

148. *Id.* at 79.

149. *The Doctrine of Necessity and Critical Vendor or Essential Supplier Status in Chapter 11 Reorganization Cases*, K&LNG ALERT at 2 (Sept. 2006) [hereinafter *Doctrine of Necessity*], https://www.bankruptcylitigation.blog/wp-content/uploads/sites/427/uploads/file/critical%20vendor%20circuit%20review(2).pdf.

150. In re Kmart Corp., 359 F.3d 866, 871 (7th Cir. 2004).

151. *Doctrine of Necessity*, *supra* note 149 at 2.

gifting, if it's even *possible* for critical vendor orders to be approved, a vendor who enjoys reorganization-killing leverage is prudent to swear that it absolutely and unequivocally will not ship without getting paid off first, not even for cash, and there is no way to assess the credibility of that assertion.[152]

In sum, then, this Article's third major critique of Chapter 11 today is that there are a number of value-reallocating distributions that favor some parties with power over others, violating fundamental bankruptcy distributional norms.

And contributing to that practice is the combined effect of the last two criticisms of Chapter 11 today, which are, first, that current venue rules allow debtors to forum shop and find a court where all their fondest wishes will be granted, and finally and relatedly, those courts write their own law to grant those wishes, without worrying about whether their judicial version of the bankruptcy law squares with the legislative one that Congress left. Or stated technically and with reference to statutes, in combination, the abuse and misuse of 28 U.S.C. § 1408 (the venue statute) along with § 105(a) of the Bankruptcy Code, has helped contribute to the current unfortunate state of Chapter 11 practice.[153]

Let's turn first to venue choice and the race to the bottom forum shopping that has resulted from the improvident rules of § 1408.

D. Forum Shopping & the Race to the Bottom

One of the most controversial aspects of Chapter 11 practice today is the astonishing ease with which a corporate debtor can pick where it files.[154] Under the case venue rules of § 1408 of the Judicial Code, with just a modicum of planning, a corporate debtor can basically file anywhere in the United States.[155] Put bluntly, the debtor can forum shop. And that readily available forum shopping may trigger an undesirable "race to the bottom."[156] Almost by definition, if a debtor can shop for a forum, for whichever forum it ends up choosing, it did so for a reason, and the reason is highly likely to be favorable to the debtor, and perhaps

---

152. *Id.* at 2–3.

153. Douglas G. Baird, *Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren*, 54 U. CHI. L. REV. 815, 819 (1987); LoPucki, supra note 59, *at 16.*

154. *See* TABB, *supra* note 7, at 375–77; the harshest critic is Lynn M. LoPucki. *See, e.g.*, LoPucki, *supra* note 59, at 15.

155. 28 U.S.C. § 1408 (2021).

156. Lyn M. LoPucki & Sara D. Kalin, *The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of A "Race to the Bottom",* 54 VAND. L. REV. 231, 271 (2001).

concomitantly less desirable for other stakeholders.[157] Because of this possibility, some critics have charged, and this author tends to agree with them, that those controlling the filing (typically the debtor-as-DIP, but possibly a controlling secured lender or putative purchaser) can seek to file in a court that they believe will be more sympathetic to them, in whatever way is most important to the party in control, be it a point of law, or fees allowed, or DIP financing terms, or whatever.[158]

The problem is exacerbated when considered in conjunction with the final problem which this Article will discuss next, which is an excessive use of judge-made law under § 105(a). In sum, a debtor (or whomever is controlling the filing) can pick the court where the law and practice is most favorable to them. Want to pay off favored creditors? Or have access to incredibly generous DIP financing terms? No problem! Just pick a court that you know will give you what you want. Thus, the pejorative—but perhaps accurate—phrase "race to the bottom."

To quickly recap the bidding on case venue under § 1408, there are two options. The first option is direct venue for the particular debtor, under § 1408(1).[159] The second option is "affiliate" venue under § 1408(2).[160]

For direct venue, there are four possibilities. Any of the four is fine. They are: domicile, residence, principal place of business in the United States, or location of principal assets in the United States.[161]

The one that has opened the floodgates of choice and has led to the explosion in the use and importance of the Delaware bankruptcy court, dating back to the halcyon days of the early '90s when the honorable Helen Balick was the only bankruptcy judge in Delaware, so Delaware filers could be certain that Judge Balick would get their case—is "domicile."[162]

That is because a corporation is domiciled in its place of incorporation.[163] Accordingly, no matter where a company has its headquarters or principal place of business, if it is incorporated in Delaware, it can file Chapter 11 in Delaware.[164] Lots of companies are

157. *See, e.g.*, Laura Napoli Coordes, *The Geography of Bankruptcy*, 68 VAND. L. REV. 381, 389, 406, 408 (2015).

158. *Id.* at 389.

159. § 1408(1).

160. § 1408(2).

161. § 1408(1).

162. Andrea Rothman, *Helen Balick's Bailiwick Is a Backwater No More*, BLOOMBERG (Nov. 29, 1992, 1:00 PM), https://www.bloomberg.com/news/articles/1992-11-29/helen-bailiwick-is-a-backwater-no-more.

163. 28 U.S.C. § 1332(c)(1) (2021).

164. *See id.*

incorporated in Delaware, as everyone knows.[165] And of course, it is easy to change the place of incorporation, and the only limitation the venue statute imposes on moving domicile before filing is that the debtor has to be domiciled in the state of filing for the greater part of the 180 days before filing; in practice then, moving ninety-one days before filing works.[166]

So, any corporation can end up in the very debtor-friendly Delaware bankruptcy court by the simple expedient of being incorporated in Delaware for at least ninety-one days before filing.[167]

On the positive side, it must be noted that many bankruptcy professionals now like Delaware precisely because the judges there are very experienced in managing big cases and know what they are doing.[168] Plus, lawyers now know where to stay and where to get dinner in Wilmington.

Incorporating in the jurisdiction of choice is not the only forum shopping opportunity in the venue statute. Another such statute is the so-called "affiliate hook" in § 1408(2).[169] A debtor may file bankruptcy in a district where there is currently pending a case concerning an "affiliate" of the debtor.[170] Perhaps surprisingly, the definition of "affiliate" in § 101(2) covers anyone in the same corporate group as the debtor, whether a parent, subsidiary, or sister corporation.[171] Accordingly, a tiny subsidiary can file first directly under § 1408(1) in the desired venue, then the parent can follow suit under § 1408(2).[172] The 1997 National Bankruptcy Review Commission recommended that § 1408(2) be amended to only permit a debtor corporation to follow its parent,[173] but that prudent suggestion has not been adopted by Congress.

Examples of tail-wagging-the-dog "affiliate" filings, where the parent follows a subsidiary into the desired venue, are numerous. Perhaps the best known is the Enron case, which ended up in New York through the affiliate hook when a small subsidiary named Enron Metals first filed in New York, paving the way for Enron itself to follow suit in New York—even though Enron indisputably was headquartered and centered

---

165. *See Why Businesses Choose Delaware, Division of Corporations*, DELAWARE.GOV, https://corp.delaware.gov/why-businesses-choose-delaware/ (last visited Mar. 6, 2019).

166. § 1408(1).

167. *Id.*

168. *See e.g.* Coordes*, supra* note 157, at 389.

169. § 1408(2).

170. *Id.*

171. 11 U.S.C. § 101(2) (2021).

172. *Id.*; *see also* § 1408(1)–(2).

173. NAT'L BANKR. REV. COMM., BANKRUPTCY: THE NEXT TWENTY YEARS 770–71, 774–75 (1997), available at http://govinfo.library.unt.edu/nbrc/report/01title.html.

in Houston.[174] So, too, did Eastern Airlines, without question a Miami-based company, end up in the New York court, following the filing of its frequent flyers club (named Ionosphere Clubs) in New York.[175]

Is this virtually unlimited venue choice a bad thing? Reasonable people disagree.[176] Count this author in the camp of critics. As this Article will explain in its "remedies" section in its final part, the author thinks that a corporation's venue choices should be more constrained, and that such readily available forum shopping should be eliminated. The author does not intend to impugn the good faith of any bankruptcy judge. But there are multiple problems with unfettered venue choice.

Firstly, why should the debtor (or whomever is controlling the filing) have the power to pick its law, or whichever other goody it desires? That gives the debtor an unfair advantage over other stakeholders. It also undermines, or at least calls into question, the very notion of having a rule of law, and a national federal law. If critical vendor orders are hard to get in the Seventh Circuit (and they are, after *Kmart*[177]), should a Chicago-based company really be allowed to eschew filing in the Windy City and opt instead for the critical-vendor-friendly confines of Delaware?[178] Or if the debtor's insiders want a third-party release, and their company inconveniently is located in a circuit which severely limits the enforceability and legality of such orders, do we really want them to be able to cherry-pick another circuit that takes a more generous view to such releases? No. Allowing that possibility also might lead to some courts competing for big cases by issuing orders that they believe will be attractive to debtors and financiers who control the choice of venue.

One also might be critical of the inconvenience and unfairness of forcing creditors or employees who have dealt with or worked for what they accurately saw as a Chicago company, or (in Enron) a Houston company, or (in Eastern) a Miami company, or whatever, to appear in a distant forum.

At bottom, and perhaps most damning, forum shopping and unlimited venue choice undercut the perceived legitimacy of the bankruptcy system. That, this Article submits, is a big price to pay—too

---

174. Dan Ackman, *Enron's Creditors: Y'all Come Back to Texas*, FORBES (Jan. 8, 2002, 9:13 AM), https://www.forbes.com/2002/01/08/0108topnews.html#4dd5e3cc3038; *see In re* Enron Corp., 274 B.R. 327, 334 (Bankr. S.D.N.Y. 2002).

175. Robert E. Dallos & Paul Richter, *Eastern Files for Bankruptcy, Blames Pilots*, L.A. TIMES (Mar. 10, 1989), http://articles.latimes.com/1989-03-10/news/mn-1205_1_eastern-airlines.

176. *See* TABB, *supra* note 7, at 375 n.362 (citing sources).

177. *See In re* Kmart Corp., 359 F.3d 866, 874 (7th Cir. 2004).

178. *See In re* Just for Feet, Inc., 242 B.R. 821, 826 (D. Del. 1999).

big. Venue choice should be radically reformed, so as to sharply curtail the possibility of forum shopping.

E. Judicial Legislation Under § 105(a)

The final concern this Article will raise is closely connected with the forum selection problem. That is the problem of bankruptcy judges writing the law they think best through a capacious application of § 105(a) and their equitable powers.[179] Almost from the day the ink was dry on the Bankruptcy Reform Act of 1978, bankruptcy judges have been rewriting the law that Congress gave us to make it "better." This Article would call this "judicial legislation," which, of course, as the name suggests, should not happen in our three-branch system of government.

Often the judicial legislation under § 105(a) involves authorizing payouts that vary from the Code's priority scheme, a problem we discussed earlier. It has therefore come to pass that critical vendor orders, structured dismissals, gifting plans, and sub rosa "sale" orders, all have been blessed by bankruptcy courts grabbing their equitable pen and altering the terms of the Bankruptcy Code.

It's as if we still are living in the long-ago environs of equity receiverships, where there was no statutory law, and judges did have to write the law. But now there is a statute. It's a long one. Hundreds of pages. For better or worse, Congress gave us the Bankruptcy Code. As a matter of separation of powers, this Article submits that bankruptcy judges should have to live with the law Congress wrote and have no power to "fix" that law by invoking their equitable powers under § 105(a). It is important to note that, for the most part at least, the Supreme Court agrees.[180] From time to time, the Court has stepped in and nixed, usually on separation of powers grounds, the judicial rewriting of the Bankruptcy Code.

So, for example, back in the 1990s, lower courts started subordinating nonpecuniary loss tax penalty claims by invoking their equitable powers. In 1996, in *United States v. Noland*,[181] the Supreme Court stopped this practice, holding that such a categorical decision was reserved for the Congress, and a court could not usurp that power.[182] The essence of the concern was captured nicely by the *Noland* Court's approving quote from a Ninth Circuit decision: "[T]he [equity] chancellor never did, and does not now, exercise unrestricted power to contradict

179. *See* 11 U.S.C. § 105(a) (2021).
180. *See e.g.* U.S. v. Noland, 517 U.S. 535, 536 (1996).
181. *Id.* at 536.
182. *See id.* at 543.

statutory or common law when he feels a fairer result may be obtained by application of a different rule."[183] That, this Article submits, is exactly what bankruptcy courts have been doing when they do things like approve critical vendor orders, or gifting plans.

After *Noland*, though, nothing really changed with regard to the general practice of bankruptcy judges giving the Bankruptcy Code a "helping hand" through the expansive application of their equitable powers under § 105(a).[184] Occasionally a court would go too far and enter a § 105(a) order that directly contradicts a Code provision.[185]

An example was *Law v. Siegel,* in which the lower courts surcharged a debtor's exemption with administrative expenses, even though § 522(k) specifically says that exemptions cannot be surcharged with administrative expenses.[186] In the face of such flagrant disregard of separation of powers, the Supreme Court again had to step in and say, basically, "stop that!"[187] The *Law* court concluded that "in exercising those statutory and inherent powers, a bankruptcy court may not contravene specific statutory provisions" and "that 'whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of' the Bankruptcy Code."[188]

Thus, if the Code says the law is "A," then under *Law*, at the very least a bankruptcy court cannot invoke § 105(a) to rule "not A."[189] And under *Noland*, the bankruptcy court cannot invoke § 105(a) to make a categorical determination that a certain type of case that is not provided for by Congress must always come out a certain way, without considering the exact circumstances of the case before the court.[190]

But most § 105(a) orders do not either directly contradict a Code section (although orders approving gifting plans arguably do, as the Second Circuit correctly held in *DBSD,*[191] as discussed earlier), or effect

---

183. *Id.* (quoting *In re Ahlswede,* 516 F.2d 784, 787 (9th Cir. 1975)).

184. § 105; *see* Marrama v. Citizens Bank, 549 U.S. 365, 375 (2007) (citing 11 U.S.C. § 706 (2021)); *In re* Armstrong, 408 B.R. 559, 567 (Bankr. E.D.N.Y. 2009) (quoting *Marrama*, 549 U.S. at 375).

185. *See* Law v. Siegel, 571 U.S. 415, 422 (2014).

186. *See Law*, 571 U.S. at 420 (quoting Law v. Siegel, 435 Fed. App'x 697, 698 (9th Cir. 2011); *see also* 11 U.S.C. § 522 (2021).

187. *See Law*, 571 U.S. at 427–28.

188. *Id.* at 421 (quoting Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206 (1988)) (citing Raleigh v. Ill. Dep't of Revenue, 530 U.S. 15, 24–25 (2000)).

189. *See id.* at 420–21 (quoting *Marrama*, 549 U.S. at 375–76) (citing 11 U.S.C. § 105 (2021)).

190. *See Noland*, 517 U.S. at 540–41 (citing 11 U.S.C. § 510 (2021)) (quoting Hecht Co. v. Bowles, 321 U.S. 321, 329 (1944)).

191. *See In re DBSD*, 634 F.3d at 95.

a categorical determination. Instead, those equitable orders usually run contrary to a more general policy, or offend, to a greater or lesser extent, the overall statutory scheme.

The approval of structured dismissals is a good example. Arguably, the same could be said for critical vendor orders, or roll ups, or cross-collateralization. Nothing in the Code says, "critical vendor orders may not be entered," or "no roll ups," or "no structured dismissals."

The trick will be drawing the line where the contradiction of the Code's overall mandate, fairly interpreted, is too blatant. In *Jevic,* the Supreme Court rejected the approval of structured dismissals not because of a conflict with any single specific Code sections, but instead because the essence of those structured dismissal orders conflicted with the Code's general priority scheme, read broadly and holistically.[192] The *Jevic* Court's basic takeaway was that "[w]e cannot 'alter the balance struck by the statute,' not even in 'rare cases.'"[193] And as noted earlier, the *Jevic* Court suggested in dictum that interim payment orders, such as critical vendor orders, might be okay.[194] As I stated earlier, I am less sanguine than the Court on that point, and would argue that even critical vendor orders go too far, and " 'alter the balance struck by the statute.'"[195]

But the point here is not to quibble about particulars, but to raise a red flag with respect to a broader issue and what seems to be a fairly ubiquitous practice. Notwithstanding cases such as *Noland,* or *Law*, or *Jevic,* bankruptcy courts tend to embrace the view that § 105(a) gives them *carte blanche* to do just about anything they want, without having to worry about what the Code itself says. In doing so, I again worry that the very rule of law itself, not to mention the fairness and integrity of the Chapter 11 system, is called into question, and found wanting.

III. MAKING THE DREAM A REALITY

To recap, then, the five biggest concerns about Chapter 11 today are, first, that § 363 sales have largely replaced Chapter 11 reorganizations; second, that secured creditors rule and get most of the reorganization value; third, that distributions are routinely made that diverge from the Congressionally-mandated priority scheme; fourth, that unfettered venue choice has led to excessive forum shopping; and fifth, that bankruptcy

---

192. *See* Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 983–87 (2017) (citing Whitman v. Am. Trucking Ass'ns, 531 U.S. 457, 468 (2001)) (quoting *In re* Jevic Holding Corp., 787 F.3d 173, 186 (3d Cir. 2015)).

193. *Jevic*, 137 S. Ct. at 987 (quoting Law v. Siegel, 571 U.S. 415, 422 (2014) (citing Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 207–08 (1988)).

194. *See id.* at 985.

195. *Id.* at 987 (quoting *Law*, 571 U.S. at 42) (citing *Ahlers*, 485 U.S. at 207–08)).

judges are rewriting the Code under the guise of invoking their equitable powers under § 105(a). There are also concerns that Chapter 11 costs too much, and that debtor firms were avoiding filing for far too long.

So, can we fix this mess? If so, how? What are the "Rx prescriptions" for making the Chapter 11 system well again?

A. Rx # 1: Making Sales Just "Sales" Again

The first prescription, which is essential, is that § 363 sales have to go back to being just "sales" again and not surreptitious reorganizations. Most importantly, this means that courts should never approve a sale that purports to make distributional allocations amongst the parties.[196] Chapter 11 has detailed rules about voting and the standards for confirming a plan that govern how the stakeholders allocate value.[197] It is imperative that those procedural and substantive rights be preserved.

Along these lines, it is not enough for the *court* to try to make sure that sale-dictated allocations of value mirror Chapter 11 entitlements closely enough, as the *Jevic* Court appeared to suggest.[198] Rather, those parties who have "skin in the game" should retain always their statutorily granted procedural and substantive rights to decide *for themselves* whether they want to relinquish some of the value to which they are entitled.

B. Rx # 2: Resurrect the "Perishability" or "Emergency" Test for Sales

Under the Bankruptcy Act that preceded the Bankruptcy Code, the prevailing view in the courts was that a pre-plan sale of the bulk of the debtor's assets could only be approved if those assets would lose substantial value if not sold prior to a plan.[199] The statutory test was a simple "upon cause shown" standard under § 116(3) in chapter X and § 313(2) in chapter XI, but the "cause" required was strict and significant.[200]

So, for example, in *In re V. Loewer's Gambrinus Brewery Co.*,[201] the uncontroverted sale petition asserted that "'[w]ith the approach of

---

196. *See* Brubaker & Tabb, *supra* note 54, at 1380.
197. *See* 11 U.S.C. §§ 1101, 1102, 1111 (2021).
198. *See Jevic*, 137 S. Ct. at 986; *see also In re* Braniff Airways, Inc., 700 F.2d 935, 940 (5th Cir. 1983); *see also In re* Lionel Corp., 722 F.2d 1063, 1069 (2d Cir. 1983); *see also In re* Biolitec, Inc., 528 B.R. 261, 269 (Bankr. D.N.J. 2014); *see also* Ind. State Police Pension Trust v. Chrysler LLC, 576 F.3d 108, 118 (2d Cir. 2009).
199. For further analysis, see cases discussed in *In re Lionel Corp.*, 722 F.2d at 1067–68.
200. *See, e.g.*, *In re* Huntington, Ltd., 654 F.2d 578, 588–89 (9th Cir. 1981) (citing 11 U.S.C. § 116 (2021)) (quoting *In re* Solar Mfg. Corp., 176 F.2d 493, 494 (3d Cir. 1949)).
201. 141 F.2d 747, 747 (2d Cir. 1944).

warm weather the vats, kettles and other brewing machinery will, because of lack of use and refrigeration, deteriorate rapidly and lose substantially all of their value.'"[202] In approving the sale, the Second Circuit relied most fundamentally on the proposition that "the disposition of the property could not be longer delayed without peril to all interests."[203] Or as the Third Circuit held in another case, "sales under court order not in pursuance of a reorganization plan are to be confined to emergencies where there is imminent danger that the assets of the ailing business will be lost if prompt action is not taken."[204]

Congress should adopt a similar "emergency" or "perishability" standard to approve pre-plan major asset sales under § 363. If that were done, parties could no longer routinely eschew Chapter 11 and go the sale route instead.[205] Major asset sales would only be possible when the alternative of waiting for a plan would hurt everyone because of the substantial loss of value.

Under such a "wasting asset" or "melting ice cube" test, objective economic evidence would corroborate the need to move quickly via sale, which would make it much harder for controlling parties to do an end run around the safeguards of Chapter 11 simply by saying so.[206] The commonplace use of § 363 sales in lieu of traditional Chapter 11 reorganizations would cease. Very few cases would satisfy such a test.

C. Rx # 3: Limit Secured Creditors to Foreclosure Value

What can be done about the second major identified problem, which is that secured lenders have effectively tied up all value and control the process to their benefit and effectively capture most of the reorganization value for themselves? The first suggestion, and third Rx overall, is to limit secured creditors to foreclosure value, both with respect to the provision of adequate protection during the case, and for purposes of "cram down" under a reorganization plan.

---

202. *Id.* at 748.
203. *Id.* at 749.
204. *In re Solar*, 176 F.2d at 494.
205. *See id.* at 494–95 (holding cases under bankruptcy code give courts a more concrete standard to apply); *see* Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 986 (2017); *see also In re* Braniff Airways, Inc., 700 F.2d 935, 940 (5th Cir. 1983); *see also In re* Lionel Corp., 722 F.2d 1063, 1069 (2d Cir. 1983); *see also In re* Biolitec, Inc., 528 B.R. 261, 269 (Bankr. D.N.J. 2014); *see also* Ind. State Police Pension Trust v. Chrysler LLC, 576 F.3d 108, 118 (2d Cir. 2009).
206. *Jevic*, 137 S. Ct. at 986 (citing *In re Braniff*, 700 F.2d at 940).

Outside of bankruptcy, all that a secured creditor can recover on its collateral is the foreclosure value.[207] Accordingly, anything over and above that which the secured creditor receives in a Chapter 11 bankruptcy case is not attributable to its non-bankruptcy rights but to value added solely due to the procedures and protections of the bankruptcy case.[208] There is no reason to allocate that excess value solely to the secured lender.

Furthermore, if Chapter 11 bankruptcy was not seen as a means by which a secured creditor could foreclose for more on its collateral than it could outside of bankruptcy, the incentive for that creditor to trigger what could be called "Chapter 11 foreclosures" would be sharply curtailed. Doing so also would help cure the excessive use of § 363 sales. As a matter of distributional fairness, allowing some of the going concern value to be captured by other stakeholders in the enterprise would be laudable and appropriate.

So, too, as will be discussed in the fourth prescription, limiting a secured creditor's entitlement to foreclosure value could help open up DIP financing, which would weaken the pre-bankruptcy secured lender's monopolistic hold on the debtor and the Chapter 11 case.

D. Rx # 4: Open Up DIP Financing & Eliminate Draconian Terms

A major part of the second problem, which is secured creditor capture of the process, concerns the nature and terms of DIP financing. To make Chapter 11 work again, it is necessary to find some ways to break the secured lender's monopolistic control over DIP financing.[209] This Article presents two suggestions.

First, courts should never approve, no matter what, any of the abusive and draconian terms that do anything other than speak to the security of repayment of the DIP loan. Basically, courts should call the lender's bluff, and make the lender decide whether it's willing to do the DIP financing solely on the basis of what it's making on that DIP loan and what security there is for repayment of the new money advanced. If the lender is not willing to finance without getting extraordinary goodies, that tells us a lot about the lender's view of the viability of the case. And if the ban to getting what are essentially monopolistic rents is known to the lender *in advance*, it won't push for a Chapter 11 filing designed primarily to feather its own nest.

207. *See* John D. Ayer et al., *"101", What Every Secured Creditor (and Its Lawyer) Should Know About Chapter 11*, 22-9 AM. BANKR. INST. J. 22, 22, (2003).
208. *See id.* at 22–23.
209. *See id.* at 58 (citing 11 U.S.C. § 364 (2005)).

Accordingly, this Article recommends that courts (or the Congress) ban entirely and without exception familiar but patently unfair clauses such as roll ups, cross-collateralization, avoidance power recovery liens, waivers of objections to the secured lender's pre-petition position, waivers and stipulations regarding § 506(c) and § 552(b), contingency milestones and benchmarks, and prohibitions on other lenders doing DIP financing.

The second suggestion speaks to opening up the DIP financing market. If competition to make the DIP loan is possible, then by definition the monopoly is broken, and monopolistic rents cannot be captured. There are two possible ways to accomplish this. First, inter-creditor agreements that would preclude a junior lender from doing the DIP financing should never be enforced. They should be void and unenforceable as against public policy.

Second, as mentioned in the third Rx, the provision of adequate protection for the pre-bankruptcy secured lender should be measured against foreclosure value. Among other things, doing so would open up substantially the possibility of the court approving a priming lien under § 364(d). The excess going-concern value that could be projected to be recovered would suffice as adequate protection for the primed lien.

E. Rx # 5: Eliminate All Preferential Priority-Altering Payments

The fifth prescription is to eliminate all forms of judicially approved preferential payments that alter distributional priority entitlements. Basically, I would see the *Jevic* Court's blanket proscription of priority-altering payments upon exit from the case, absent the consent of the negatively affected parties,[210] and raise it to include pre-exit distributions, and thus prohibit any and all preferential payments *during* the case. Notably, this Rx would ban entirely all critical vendor orders.

As discussed *supra*, the fundamental problems with such orders, aside from the fact that some unsecured creditors get paid more than others, undermining the equality norm, are, firstly, that the only reasons for such orders are either extortion or collusion—both of which are bad reasons to pay someone—and secondly, that the necessary "proof" of whether the preferred party with leverage would or would not play ball in the reorganization without getting preferred is impenetrable factually.[211] If they say they won't, there is no way for the judge to sort out on the spot whether they really would or would not. But if their bluff

---

210. *See Jevic*,137 S. Ct. at 978, 983–85.

211. *See id.* at 986–87 (citing U. S. v. Embassy Rest., Inc., 359 U.S. 29, 32 (1959) (quoting H.R. Doc. No. 93-137, at 255 (1973)).

is called up front and in advance, the supposedly critical vendor would have to make an honest and unbribed decision whether it wanted to make more sales or not.[212]

And, following up on the basic premise of *Jevic*, there is no effective way for the negatively affected non-preferred parties to "consent" to an emergency first-day critical vendor order. Indeed, it is commonplace for some non-preferred creditors to object and yet have the bankruptcy judge approve the order anyway.

F. Rx # 6: Curtail Venue Choice and Forum Shopping

The sixth prescription is to amend 28 U.S.C. § 1408 so as to curtail venue choice and thereby largely eliminate forum shopping and the concomitant "race-to-the-bottom." The fixes are simple, both for direct venue under § 1408(1) and for affiliate venue under § 1408(2).

For direct venue, this Article proposes a return to the test under the prior Bankruptcy Act for chapter X cases in § 128, that venue is proper where the debtor corporation "has had its principal place of business or its principal assets" for the greater portion of the preceding six months.[213] Doing so takes the place of incorporation (and thus "domicile") out of the equation. Goodbye, Delaware! For affiliate venue, this Article also proposes a return to the chapter X test, in Act § 129, whereby a subsidiary can follow a parent into a particular venue, but not the other way around.

With these simple cures, major corporate debtors would have to file where they are. Enron would file in Houston. Eastern Airlines would file in Miami. And so forth. Doing so would eliminate forum shopping, unless a corporation were willing to actually move its headquarters to a chosen forum in advance of bankruptcy, which is a much more dramatic and frankly unlikely step.

Eliminating forum shopping would remove most of the unfair advantages that those controlling filings have enjoyed in recent decades. And it would significantly enhance the integrity, and the perceived integrity, of the Chapter 11 system, and promote adherence to the rule of law.

G. Rx #7: No More Judicial Legislation

The final prescription is that bankruptcy judges should stop viewing § 105(a) as a license to write a bankruptcy law that the judges think is better than the one Congress gave us. The scope of equitable power under

212. *See* Ayer et al., *supra* note 207, at 22 (citing §§ 363(f) and (k)).
213. Capitol Motor Courts v. Le Blanc Corp., 201 F.2d 356, 359 (2d Cir. 1953); 11 U.S.C. § 528 (2021).

§ 105(a) should be constrained not only by not being able to contradict a specific Code rule (as prohibited in *Law*[214]), or to enact categorical rules without reference to particular cases (as prohibited in *Noland*[215]), but also to not "alter the balance struck by the statute," as suggested in *Jevic.*[216] As to the final "alter the balance" point, this proposal would prohibit courts doing things like approving critical vendor orders, which change priorities.

I am torn as to how to implement this "no judicial legislation" prescription. The problem is that no matter what the Supreme Court has said about not doing this, bankruptcy courts keep rewriting the law anyway. Perhaps it would be necessary to amend § 105(a) itself with a standard limiting the scope of the judge's powers.

CONCLUSION

This Article explores concerns about five problems with Chapter 11 practice today, and how Chapter 11 is not realizing its potential. Those problems are, first, that § 363 sales have largely supplanted traditional Chapter 11 reorganizations; second, that secured lenders have too much control and capture too much value; third, value is distributed unfairly; fourth, venue choice has led to excessive forum shopping; and last, bankruptcy judges invoke § 105(a) too often to rewrite the bankruptcy law in ways that contradict the essence of the statutory scheme.

This Article has suggested a few prescriptions for change to address those problems. First, it recommends making sales just sales again, and not allowing sales to dictate distributions. Second, it suggests resurrecting an emergency or wasting asset test for sales. Third, secured creditors should be limited to foreclosure value, both as a matter of adequate protection and in cram down under reorganization plans. Fourth, it recommends opening up DIP financing and restricting the availability of draconian terms. Fifth, it suggests outlawing all pre-plan priority-altering preferential payments. Sixth, it recommends amending the venue statute to limit forum shopping. And last, it suggests limiting the power of judges under 105(a) to rewrite the statutory scheme.

If these prescriptions were to be adopted, and this were a game of craps, the hope is that the "come out" roll of the reorganization dice would be a "natural" 11 and that pass line bettors who put chips on the "yo" bet would win. As things stand today, though, everyone except a

214. *See* Law v. Siegel, 571 U.S. 415, 421 (2014) (citing *Norwest*, 485 U.S. at 206)).
215. *See Noland*, 517 U.S. at 536.
216. *See* Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 987 (2017) (citing *Law*, 571 U.S. at 427).

lucky few "crap out" almost every time. Maybe we should all just play "blackjack" or "Texas hold 'em" instead.